SUPREME COURT, U. S.

Supreme Court, U.S.
FILED
NOV 5 1971
ROBERT SEAVER, CLERK

In The

Supreme Court of the United States

OCTOBER TERM 1971

No. 70-79

RELIANCE ELECTRIC COMPANY,

Petitioner,

v.

EMERSON ELECTRIC COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

REPLY MEMORANDUM OF GULF & WESTERN INDUSTRIES, INC. IN SUPPORT OF ITS MOTION FOR LEAVE TO FILE A BRIEF AS AMICUS CURIAE

WHITNEY NORTH SEYMOUR,
One Battery Park Plaza,
New York, New York 10004,
Counsel for Gulf & Western Industries, Inc.

Of Counsel:
JOHN A. GUZZETTA,
BERNHARDT K. WRUBLE,
Simpson Thacher & Bartlett.

INDEX

	PAGE
Statement	1
Argument	1
Conclusion	6

Citations

Cases:

Adler v. *Klawans*, 267 F.2d 840 (2 Cir. 1959)	4
Blau v. *Lehman*, 368 U.S. 403 (1962)	4
Blau v. *Lamb*, 363 F.2d 507 (2 Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967)	4
Gratz v. *Claughton*, 187 F.2d 46 (2 Cir.), *cert. denied*, 341 U.S. 920 (1951)	5
Petteys v. *Butler*, 367 F.2d 528 (8 Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967)	4

Statutes:

Section 16(b) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. 78p(b)	4

Miscellaneous:

Hearings before the Senate Committee on Banking and Currency, 73d Cong., 1st and 2d Sess.	4
H. R. 8720, 73d Cong., 2d Sess.	3, 6
H. R. 9323, 73d Cong., 2d Sess.	6
2 Loss, *Securities Regulation* (2 Ed. 1961)	5
5 Loss, *Securities Regulation* (2 Ed. Supp. 1969)	4
Senate Bill No. 3420, 73d Cong., 2d Sess.	2
Senate Report No. 792, 73d Cong., 2d Sess.	2
Senate Report No. 1455, 73d Cong., 2d Sess.	3, 5

In The

Supreme Court of the United States

OCTOBER TERM 1971

No. 70-79

RELIANCE ELECTRIC COMPANY,

Petitioner,

v.

EMERSON ELECTRIC COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

REPLY MEMORANDUM OF GULF & WESTERN INDUSTRIES, INC. IN SUPPORT OF ITS MOTION FOR LEAVE TO FILE A BRIEF AS AMICUS CURIAE

Statement

This memorandum is submitted in reply to the "Memorandum in Opposition to Motion of Gulf & Western Industries, Inc. for Leave to File Brief Amicus Curiae," submitted by petitioner (hereinafter "Opposition Memorandum").

Argument

I.

We do not take issue with petitioner's description of the procedural posture of this case (Opposition Memorandum, pp. 1-2). As stated in our moving papers, the pur-

pose of our motion is one to guard against the possibility that the Securities and Exchange Commission ("SEC"), through its formulation of the "Question Presented," might persuade the Court to adjudicate an issue which was not the subject of a petition for certiorari and which has not been tendered or briefed by either party. Resolution of such an important issue, arising in contexts scarcely envisioned by the 73d Congress, should, we believe, await a case where it is the subject of arguments by the parties immediately concerned, and be decided by this Court only after the refinement of such arguments which may be expected in the lower and intermediate courts.

II.

1. The Opposition Memorandum points to an inadvertent error in our proposed brief *amicus curiae*, in that we did not believe that Senate Bill No. 3420 contained the exemption applicable to 10% beneficial owners.* Rectification of this error does not, however, dilute the showing that Section 16(b) was designed to attack the misuse of inside information, and that its automatic application on the questionable basis of hypothesized manipulation must be justified by a defendant's official status.

As indicated at pages 12-13 of our proposed brief, we had anticipated the possibility that if Senate Bill No. 3420 did not contain an exemption for 10% beneficial owners, it might be argued that the Senate intended to impute identical abilities to 10% beneficial owners as to officers and directors. It now appears that Senate Bill No. 3420, introduced in April 1934, did in fact adopt both of the exemp-

* Such error was based upon the failure of Senate Report 792, 73d Cong., 2d Sess. (1934) to mention the addition of the exemption for 10% shareholders, and an apparent break in our own verification procedures during our attempt to assemble materials relating to the legislative history of the subsection, which we regret.

tions first presented in the House bill, H.R. 8720* introduced in March 1934. Thus, the argument which we attempted to anticipate and answer could not in fact properly be made. Rather it would appear that the Senate bill was in fact responsive to the objections raised by Senator Kean to identical treatment of official and non-official "insiders" set forth at pages 8-9 of our proposed brief—which the SEC's argument ignores—and that such a response was not, as we had believed, a last minute compromise in the conference committee.

Indeed, we note that Senate Report No. 1455, 73d Cong., 2d Sess. (1934) draws a distinction between the abilities attributed to official and non-official insiders. It is there stated that the evidence before the subcommittee showed:

> the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust *and* the confidential information which came to them in such positions, to aid them in their market activities. (*Id.* at p. 55; emphasis added.)

The practices of large shareholders were not stated to be identical to those of corporate officials, but were limited to the use of inside information:

> Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their

---

* The portion of H.R. 8720 which contained the two exemptions, and the language (separated by italics) which became the preamble of Senate Bill No. 3420, reads as follows:

> "This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale or sale and purchase of the security involved, nor any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection *of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer.*"

companies to enable them to acquire and profit by information not available to others. *Ibid.*

Moreover, reluctance to impose "automatic" liability on shareholders on the basis of hypothesized manipulation without regard to the circumstances of a particular case should follow directly from the fact that such a basis goes beyond the expressly stated scope of the statute. See *Adler* v. *Klawans,* 267 F.2d 840, 846-847 (2d Cir. 1959); cf. *Blau* v. *Lehman,* 368 U. S. 403, 413-414 (1962). The text of the statute identifies its target, without ambiguity, as the "unfair use of information" which may have been obtained by reason of a "relationship to the issuer"—not manipulation nor other kinds of knowledge which are not derived from such a relationship.

We are moved from the statement in our proposed brief (pp. 9-10) that an absence of the exemption for 10% beneficial owners in Senate Bill No. 3420 demonstrates that such exemption was intended to deal with a problem other than that suggested by the SEC. Nevertheless, it remain evident that the specialized exemption for 10% beneficial owners was not structured to cover the diverse problems that might arise in connection with such matters as the administration of fiduciary accounts and non-consensual changes in ownership. Rather, the other exemptive provision—the general power granted to the SEC to exempt transactions "not comprehended within the purpose of this subsection."* —of which the SEC's argument takes no account, is structured to meet the range of such situations with special equities and parallels the language used by Mr. Corcoran in the Senate committee hearings relating to one such problem of fiduciaries as not within the "intention" of Section 16(b).**

---

* This exemptive power has been held to be equally open to the courts. See *Pettys* v. *Butler,* 367 F.2d 528, 536 (8 Cir. 1966), *cert. denied,* 385 U. S. 1006 (1967); *Blau* v. *Lamb,* 363 F.2d 507, 519 (2 Cir. 1966), *cert. denied,* 385 U. S. 1002 (1967); 5 Loss, *Securities Regulation,* pp. 3038-9 (2 Ed. Supp. 1969).

** Hearings before the Senate Committee on Banking and Currency, 73d Cong., 1st & 2d Sess. (1934), p. 6558.

2. Of the several reasons set forth at pages 18-24 of our proposed brief showing that Section 16(b) was not designed to deal with hypothesized abuses based solely on "after-acquired information," petitioner directs its response to only one, *viz.*: our showing that Section 16(b) is inherently structured so that it cannot measure a profit based solely upon the hypothetical use of after-acquired information and that, if so applied, it will yield irrational results. Petitioner erroneously suggests that this objection was answered by Judge Learned Hand in *Gratz* v. *Claughton*, 187 F.2d 46, 50-52 (2d Cir.), *cert. denied*, 341 U. S. 920 (1951). In that case, the court was *not* dealing with the question of whether Section 16(b) should properly apply in light of the statutory exemption, which is the question involved here. Rather, the court, in assessing the constitutionality of the statute, merely addressed the broad suppositions* upon which Congress might have acted in including large stockholders within Section 16(b) in the first instance. In addition, the court dealt with the issue of what rule of damage computation should be employed *after* it had been determined that Section 16(b) was applicable. Judge Hand adopted a lowest-in, highest-out ("LIHO") rule of damage computation because the court could find no other method of computation to protect against the ability of a defendant who had an inventory of shares to shift transactions in a way that would minimize, or make it appear that there was no, "profit." *Ibid.*; see 2 Loss, *Securities Regulation*, 1062-1064 (2 ed. 1961).

It is clear that the LIHO damage rule does not purport to charge the defendant with a "profit" which cannot bear a logical relationship to his possible use of inside information, as would the after-acquired information theory. The

---

* As indicated in Senate Report No. 1455, *supra* pp. 3-4, the "control" laid to large shareholders was merely in the sense of control sufficient to acquire inside information.

LIHO rule seeks merely to insure that a profit which does bear such a relationship cannot, by clever arrangement of the transactions, be obscured.

3. Through the courtesy of the government, we have been provided with a pre-proof copy of a "Supplemental Brief" proposed to be submitted by the SEC. While we believe that the core arguments of the SEC have been met in the foregoing text, it should be carefully pointed out that the selected quotations from floor speeches of certain members of the House set forth near the close of that brief do not in any way relate to the present Section 16(b). The bill to which that broad language was addressed was H.R. 9323, which did not contain any provision for the recapture of short-swing profits.

In addition, we must point out that our proposed brief did not state, as the SEC contends, that the language of the preamble appeared only in the House version of the present Section 16(b). We stated merely (p. 10, n 6) that it had first been introduced in H.R. 8720, which the SEC appears to confirm.

CONCLUSION

The judgment of the court below should be affirmed insofar as it adjudged respondent not to be liable under Section 16(b).

Respectfully submitted,

WHITNEY NORTH SEYMOUR,
One Battery Park Plaza,
New York, New York 10004.
Counsel for Gulf & Western Industries, Inc.

Of Counsel:
JOHN A. GUZZETTA,
BERNHARDT K. WRUBLE,
Simpson Thacher & Bartlett.